BRIEF IN SUPPORT OF PETITION

The opinion of the Trial Judge, Kirkpatrick J. and the specific findings of fact are totally unsupported by evidence, copies of which are included in the Record certified to the Circuit Court and appearing in this Record at Pages 43 to 45. Pursuant to the filing of such opinion, motion was filed by the petitioner for amended findings of fact and for a new trial, which was denied because the Court found that the argument of the petitioner centered around the fourth finding of fact as contradicted by the petitioner to the effect that "the product was manufactured in accordance with the formula". The Court in considering the petition so filed referred to the opinion of the District Court filed in the revocation proceedings involving the existence of the permit issued to the principal Stein, which opinion was affirmed by the Circuit Court of Appeals in *Stein vs. Doran*, 46 Fed. 2nd 738, the Court entirely losing sight of the fact that the proceeding before it was utterly different than the proceeding involved seeking revocation of such permit, and therefore, not only a different quantum of evidence was necessary, but an entirely different type of evidence in that in the revocation proceedings the testimony had to do with the trust and confidence of the government as reposed in Stein and his necessity and use of and for the specially denatured alcohol granted to him tax free by virtue of the permit, while in the second case the issue involved was as to whether or not permittee had *actually* diverted the alcohol so withdrawn tax free to a potable beverage and taxable purpose, either deliberately or had cooperated or conspired with third persons with full knowledge of their intentions to the end that the alcohol so accorded him tax free might evade the payment of just taxes attachable to beverage alcohol. In this connection the Court's attention is respectfully called to the provisions

of Sections 4 and 5 of Title 2 of the National Prohibition Act, c. 85, 41 Stat. 305, reading as follows:

"Sec. 4. The articles enumerated in this section shall not, after having been manufactured and prepared for the market, be subject to the provisions of this Act if they correspond with the following descriptions and limitations, namely:

(a) Denatured alcohol or denatured rum produced and used as provided by laws and regulations now or hereafter in force.

(b) Medicinal preparations manufactured in accordance with formulas prescribed by the United States Pharmacopoeia, National Formulary or the American Institute of Homeopathy that are unfit for use for beverage purposes.

(c) Patented, patent, and proprietary medicines that are unfit for use for beverage purposes.

(d) Toilet, medicinal, and antiseptic preparations and solutions that are unfit for use for beverage purposes.

(e) Flavoring extracts and sirups that are unfit for use as a beverage, or for intoxicating beverage purposes.

(f) Vinegar and preserved sweet cider.

A person who manufactures any of the articles mentioned in this section may purchase and possess liquor for that purpose, but he shall secure permits to manufacture such articles and to purchase such liquor, give the bonds, keep the records, and make the reports specified in this Act and as directed by the commissioner. No such manufacturer shall sell, use, or dispose of any liquor otherwise than as an ingredient of the articles authorized to be manufactured therefrom. No more alcohol shall be used in the man-

ufacture of any extract, sirup, or the articles named in paragraphs b, c, and d of this section which may be used for beverage purposes than the quantity necessary for extraction or solution of the elements contained therein and for the preservation of the article.

Any person who shall knowingly sell any of the articles mentioned in paragraphs a, b, c, and d of this section for beverage purposes, or any extract, or sirup for intoxicating beverage purposes, or who shall sell any of the same under circumstances from which the seller might reasonably deduce the intention of the purchaser to use them for such purposes, or shall sell any beverage containing one-half of 1 per centum or more of alcohol by volume in which any extract, sirup, or other article is used as an ingredient, shall be subject to the penalties provided in section 29 of this Title. If the commissioner shall find, after notice and hearing as provided for in this section 5 of this Title, that any person has sold any flavoring, sirup, extract, or beverage in violation of this paragraph, he shall notify such person, and any known principal for whom the sale was made, to desist from selling such article; and it shall thereupon be unlawful for a period of one year thereafter for any person so notified to sell any such extract, sirup, or beverage without making an application for, giving a bond, and obtaining a permit so to do, which permit may be issued upon such conditions as the commissioner may deem necessary to prevent such illegal sales, and in addition the commissioner shall require a record and report of sales (41 Stat. 309)."

Admitted the principal Stein was authorized to manufacture toilet and antiseptic preparations, a solution unfit for beverage purposes, *and it cannot be controverted*, that the specially denatured alcohol withdrawn tax free by Stein was at the time of such withdrawal *unfit for beverage pur-*

poses. Subsequent to such withdrawal, it was required under the terms of the permit that the principal Stein add thereto certain essential oils and other ingredients for the purpose of completing the product, samples of which product had been submitted to the Treasury Department prior to the approval of the permit, and the purpose of which was to determine the potability of the finished product.

Pursuant to receipt of the basic ingredient specially denatured alcohol, the principal Stein proceeded to manufacture the products described by trade names in his application and approved by issuance of the permit.

Under the supervision of agents of the Bureau of Internal Revenue and upon completion of such manufacture, samples thereof were obtained and forwarded to the Division of Technology, Bureau of Internal Revenue, for analysis. It developed, at least allegedly, that while the formulae followed by the manufacturer Stein was quantitatively correct, there arose some question as to the quality of the essential oils used in the manufacture of the product, which according to the contentions of the Revenue Department were not of such quality as to render the finished product incapable of redistillation and manipulation for the purpose of securing a potable beverage alcohol.

The Record, Page 36 clearly indicates that the original sample of essential oil submitted to the Treasury Department was not available for the purpose of comparison with the essential oils used in the manufacture by the principal Stein and supervised by Revenue agents at the time of manufacture.

It is readily apparent that in the absence of the original approved essential oil that comparison of the oil used in the manufactured product with the approved ingredient is utterly impossible, but, going beyond that, the contention of the petitioner is this, that in the event the essential oil

was compared with the original approved essential oil ingredient, and even if such comparison proved that the manufactured oil was inferior, that such fact does not give rise to tax liability under the terms of the bond, unless and until it has been established that not only did such introduction of an inferior ingredient render the manufactured product potable or possibly potable, but that it must be established that diversion was actually established.

Under the facts of record in this case, it is submitted that not only did the evidence fail to establish diversion, but it definitely failed to establish either intent on the part of Stein, the principal, to so divert or knowledge of diversion on the part of others to whom he sold his finished product.

The provisions of Section 4 of Title 2, exempting certain articles from the provisions of the Prohibition Act, which in Paragraph D specifically exempts toilet products, provided that a person manufacturing such products may secure alcohol for such purpose, and shall not dispose of the same otherwise than as an ingredient of the articles authorized to be manufactured therefrom.

The most important part of the present petition with respect to tax liability is based on this Section, because of the fact that it provides that any person who sells any of the articles referred to in such Section, for intoxicating beverage purposes or under such circumstances from which the intention of the purchaser be reasonably deduced, shall be subject to the penalties of Section 29 of said Title, Section 29 being as follows:

> "Sec. 29. Any person who manufactures or sells liquor in violation of this title shall for a first offense be fined not more than $1,000, or imprisoned not exceeding six months, and for a second or subsequent offense shall be fined not less than $200 nor more than $2,000 and be imprisoned not less than one month nor more than five years.

> Any person violating the provisions of any permit or who makes any false record, report, or affidavit required by this title, or violates any of the provisions of this title for which a special penalty is not prescribed, shall be fined for a first offense not more than $500; for a second offense not less than $100 nor more than $1,000, or be imprisoned not more than ninety days; for any subsequent offense he shall be fined not less than $500 and be imprisoned not less than three months nor more than two years. It shall be the duty of the prosecuting officer to ascertain whether the defendant has been previously convicted and to plead the prior conviction in the affidavit, information or indictment. The penalties provided in this Act against the manufacture of liquor without a permit shall not apply to a person for manufacturing non-intoxicating cider and fruit juices exclusively for use in his home, but such cider and fruit juices shall not be sold or delivered except to persons having permits to manufacture vinegar (41 Stat. 316)."

It is readily apparent therefore that Section 29 is a penal provision and is therefore not involved in a proceedings on a bond having for its obligation the payment of taxes on alcohol withdrawn tax free and later diverted to beverage channels.

We rely upon this assertion to fortify our contention that error was committed by the Court below in failing to treat the proceedings below as a tax suit rather than a suit either to enforce a penalty or to enforce the obligation of a bond, the damage suffered under which has not been established.

It has been ruled by this Court in the *Zerbey vs. United States*, 282 Fed. 332 case that these bonds are measurable damage bonds as distinguished from forfeiture bonds. Accordingly, since the measure of damages in the instant case has never been established, it must be con-

ceded that the government considers the present bond to be a forfeiture bond and under their contention any failure whatsoever to comply with the rules and regulations, even to filing timely and monthly reports required by the terms of the permit, would justify invoking the penal provisions of the bond.

Such is not the case, for the reason that the laws and regulations pursuant to which a permit was issued, provide different proceedings for failing to comply with the terms of the permit, in that in one instance it provides that should the Commissioner find that the sale of any particular non-beverage product has been increased by reason of its susceptibility to manipulation for the purpose of securing a beverage alcohol, the Commissioner might cite the manufacturer to show cause why the manufacturing of such particular article or approved formula should not be revoked, and if upon hearing it should appear that manipulation was the real reason for the increased sale of such product, he might revoke the manufacturer's authority to continue such manufacture, and if upon failure of the manufacturer to comply with the order or direction of the Commissioner, he might revoke the permit in its entirety.

Again we point to the fact that in the revocation proceedings it is apparent from the original record that the Commissioner failed either to cite the manufacturer for revocation of the particular formula, but he also failed to give notice of desist from such manufacture.

Therefore, the Stipulation entered into with the plaintiff in the District Court in this present proceedings is very important in that the objections originally interposed to the introduction of certain testimony are doubly potent in this case, because of the difference in the proceedings and the different objectives in view, one having in mind the revocation of the permit and the present one having in mind the collection of taxes on alcohol withdrawn tax free, but later diverted to a taxable purpose and evidence of which is entirely lacking.

The Statute of Limitations applicable to tax matters limits the prosecution to a period of six years and definitely applies to the instant case inasmuch as tax liability must either be established by hearing or admitted by the principal within such period before a surety guaranteeing such taxes may be called upon to answer, as otherwise the mere giving of a bond might indefinitely toll the Statute and cause the surety to carry a potential liability forever.

It cannot be contradicted that with reference to the facts in the instant case the evidence does not sustain any tax liability based on diversion to beverage purposes, since it fails to establish that the alcohol withdrawn tax free by the principal, at any time found its way to a taxable beverage purpose. Therefore, the reference both by the District Court and Appellate Court to the opinion filed in the case of *United States vs. Bornn*, 104 Fed. 2nd, 641 does not apply because in the Bornn case it was definitely established that the permittee principal on the bond, Bornn, was fully cognizant of the purposes to which his product was being applied, and cooperated in such purposes by helping to promote increased sale and disposition of his product, suggesting to his salesmen that they inform prospective purchasers as to the methods to be followed in converting his articles to a potable beverage use, thereupon becoming a principal and a co-conspirator and accordingly, liable under his bond.

The Appellate Court in determining that the matter before it was not a tax suit but a suit upon a bond, apparently lost sight of the fact that such bond was given for the purpose of guaranteeing taxes, applicable to alcohol withdrawn tax free in the event and under the terms of the bond that such alcohol might be unlawfully diverted, and since there is no proof of diversion under the evidence, it must readily appear that tax liability cannot arise, and that thereafter the proceeding was a tax suit, based upon bond obligation arising out of tax liability established as

a result of evidence definitely proving the application of such taxes to the alcohol withdrawn under the terms of the permit and the supporting bond.

Respectfully submitted,
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